Chapter Two

The Budget Outlook

The Congressional Budget Office projects that the deficit will decline in 1996 for the fourth straight year. CBO expects, however, that this trend will not continue under current budgetary policies and that changes in policy will be required to achieve a balanced budget by 2002.

Under current taxing and spending policies and CBO's assumptions about the economy, the deficit will rise from $144 billion this year to $171 billion in 1997 and $403 billion in 2006, the last year of the projection period. Those projections assume that discretionary spending grows with inflation, up to the level of the statutory caps imposed on it. Under the alternative assumption that discretionary spending is frozen at 1996 dollar levels through 2006, the deficit will continue to increase, but at a slow pace—from $159 billion in 1997 to $179 billion in 2006.

If the deficit rises to $403 billion in 2006 (under the assumption that discretionary spending increases at the rate of inflation), it will grow only modestly in relation to the size of the economy—from 1.9 percent of gross domestic product in 1996 to 3.3 percent of GDP in 2006. If the deficit increases to only $179 billion in 2006 (under the assumption that discretionary spending is frozen), its share of GDP will fall slightly, to 1.5 percent, in 2006.

Budget projections are highly uncertain, of course, and the extended projections are particularly sensitive to the performance of the economy and unexpected changes in the growth of entitlement spending. Although CBO believes that its assumptions are reasonable, minor changes can have a significant effect on deficit estimates. For example, an increase of 1 percentage point in interest rates throughout the projection period would boost the deficit by $85 billion in 2006.

This chapter summarizes CBO's new baseline projections. The baseline shows the outlook for federal revenues, outlays, and the deficit if current taxing and spending policies remain unchanged. It is not a forecast of budget outcomes, but it is useful for sketching the consequences of today's policies and serves as a benchmark for weighing proposed changes.

The chapter also provides CBO's estimates of the deficits that would result under current policies and an economic forecast that assumes a balanced budget in 2002. Rather than representing potential budgetary outcomes, those estimates show how much taxing and spending policies must be changed in order to achieve budgetary balance. They are intended to help policymakers determine a path to the balanced budget goal that is the basis for proposals by both the Congress and the President.

Although the deficit projections presented in this chapter are relatively benign through 2006—the deficit as a percentage of GDP either rises slowly or decreases slightly depending on the assumption about the path of discretionary spending—the budgetary picture is much darker in the longer run. Unless changes are made in spending or revenue policies, the impending retirement of the postwar baby-boom generation will cause the deficit to grow rapidly as a share of the economy. To assess the effect of that expected graying of the population, CBO has developed long-term projections of federal spending and revenues that are less detailed than the projections through 2006. A further discussion of those projections is found in Chapter 4.

The Deficit Outlook

The simplest and most widely used measure of the deficit is the gap between total federal revenues and outlays. CBO projects that measure of the deficit under two alternative economic forecasts—one that assumes current budgetary policy, and another that assumes a balanced budget in 2002. Unlike mandatory spending and revenues, which are governed by permanent laws, discretionary spending is subject to annual appropriations and is thus uncertain. Under each economic scenario, therefore, CBO further assumes two alternative paths for discretionary spending: one that adjusts for inflation but is subject to the existing caps on discretionary spending, and one that is frozen at nominal 1996 levels throughout the next 10 years.

The caps, which expire in 1998, were established by the Budget Enforcement Act of 1990. They cover total levels of discretionary budget authority and outlays. Since 1991, caps have applied to spending from the 13 regular appropriation bills and any supplemental appropriations. Since 1995, separate caps have applied to general-purpose spending and to spending from the Violent Crime Reduction Trust Fund (VCRTF). (General-purpose spending is all discretionary spending other than that from the VCRTF.) Roughly speaking, the caps have imposed a near-freeze on total nominal discretionary outlays for the 1991-1995 period.

Total Deficit Under Current-Policy Economic Assumptions

Under today's budgetary policies, the total deficit will reach a low this year and then resume rising (see Table 2-1). The deficit peaked at $290 billion in 1992 but is expected to dip to less than half of that level—$144 billion—in 1996. If discretionary spending keeps pace with inflation (up to the level of the statutory caps), the deficit will nearly double by 2002. If discretionary spending is held constant in nominal dollars, the rise in the deficit will be much more modest.

Adjusting the 1996 appropriations for inflation puts general-purpose discretionary spending below its cap in 1997 but above it in 1998. The first baseline projection therefore assumes that general-purpose spending will be held to the level of the cap in 1998 and will grow thereafter at the rate of inflation. Projected spending from the VCRTF is below its cap in both 1997 and 1998 and so is unaffected by the cap. Under these assumptions, the total deficit will reach $285 billion in 2002 and $403 billion in 2006.

If discretionary spending stays frozen throughout the projection period, the deficit will rise only modestly from its estimated 1996 level and will fall as a share of GDP. The deficit for 1997 under that projection will be $159 billion, increasing to as much as $187 billion in 2000 and 2005, but generally hovering around $180 billion. The deficit rises despite the freeze on discretionary spending because increases in outlays for spending authorized through permanent law (such as Medicare benefits and interest payments on the debt) rather than through annual funding decisions exceed projected increases in revenues.

Total Deficit Under Balanced Budget Economic Assumptions

CBO has also estimated the deficits that would result under current budgetary policies using the economic forecast that would be expected if the federal budget was balanced in 2002 and remained in balance thereafter. Such projections are inherently inconsistent since they result in an estimated deficit in 2002 even though the economic forecast assumes a balanced budget in 2002. They do, however, offer a useful analytic construct by providing an estimate of the changes in spending and revenue policies required to achieve the economic benefits embodied in the forecast. When used in that way, the projections are consistent because the end point is a balanced budget.

Table 2-1.
CBO Deficit Projections (By fiscal year)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
					In Billions of Dollars							
Baseline Total Deficit with Current-Policy Economic Assumptions												
Cap discretionary spending (with inflation after 1998)	164	144	171	194	219	244	259	285	311	342	376	403
Freeze discretionary spending at the1996 dollar level	164	144	159	176	182	187	174	178	178	181	187	179
Baseline Total Deficit with Balanced Budget Economic Assumptions												
Cap discretionary spending (with inflation after 1998)	164	144	165	175	182	191	194	210	225	244	265	278
Freeze discretionary spending at the1996 dollar level	164	144	154	157	145	136	111	106	96	88	84	64
Alternative Measures of the Deficit[a]												
Standardized-employment deficit[b]	192	154	177	183	205	230	243	267	291	321	354	380
On-budget deficit	226	209	242	268	305	337	354	389	421	459	503	541
					As a Percentage of GDP							
Baseline Total Deficit with Current-Policy Economic Assumptions												
Cap discretionary spending (with inflation after 1998)	2.3	1.9	2.2	2.4	2.5	2.7	2.7	2.9	3.0	3.1	3.3	3.3
Freeze discretionary spending at the 1996 dollar level	2.3	1.9	2.0	2.1	2.1	2.1	1.8	1.8	1.7	1.6	1.6	1.5
Baseline Total Deficit with Balanced Budget Economic Assumptions												
Cap discretionary spending (with inflation after 1998)	2.3	1.9	2.1	2.1	2.1	2.1	2.0	2.1	2.1	2.2	2.3	2.3
Freeze discretionary spending at the 1996 dollar level	2.3	1.9	2.0	1.9	1.7	1.5	1.2	1.1	0.9	0.8	0.7	0.5
Alternative Measures of the Deficit[a]												
Standardized-employment deficit[b]	2.7	2.1	2.3	2.2	2.4	2.5	2.6	2.7	2.8	2.9	3.1	3.2
On-budget deficit	3.2	2.8	3.1	3.3	3.5	3.7	3.7	3.9	4.0	4.2	4.4	4.5

SOURCE: Congressional Budget Office.

a. Estimates assume current-policy economic projections and that discretionary spending is adjusted for inflation up to the statutory caps that are in effect through 1998. All discretionary spending other than spending from the Violent Crime Reduction Trust Fund is assumed to equal the caps in 1998 and to grow from that level at the rate of inflation in later years.

b. The standardized-employment deficit is larger than the baseline deficits for 1995 and 1996 for two reasons: deposit insurance and receipts from spectrum auctions are not included in the standardized-employment deficit but are included in the baseline; and the economy was operating slightly above its long-term potential in 1995.

The projections therefore represent a starting point for the Congress in crafting a budget resolution to balance the budget in 2002. They are also useful for evaluating alternative plans to balance the budget, such as the President's budget submission.

If discretionary spending is adjusted for inflation (subject to the caps), the projected baseline deficit under balanced budget economic assumptions will be $165 billion in 1997 and $210 billion in 2002. In every year, those deficits are significantly lower than projections that assume current-policy economic projections and capped discretionary spending with inflation after 1998 (see Table 2-1). The difference, which amounts to $75 billion in 2002 and $254 billion over the 1996-2002 period, is a measure of the fiscal dividend that can be expected to result from balancing the budget. (A further discussion of CBO's current estimate of the fiscal dividend is provided in Box 2-1.)

If discretionary spending is not adjusted for inflation, the projected deficits using balanced budget economic assumptions will be $154 billion in 1997 and $106 billion in 2002. Thus, even if discretionary spending is frozen for another six years, balancing the budget by 2002 will require further reductions in spending or increases in taxes totaling about $100 billion in that year. Maintaining a freeze in discretionary spending will not be easy, however, because it will require a reduction in purchasing power of 18 percent over six years—even at the low levels of inflation CBO anticipates.

Alternative Measures of the Deficit

Although the total deficit is the most common measure of the deficit, analysts often cite two other measures of the amount by which the government's spending exceeds its revenues. One measure removes cyclical factors from the deficit calculation, and the other removes spending and receipts designated by law as off-budget.

Cyclical economic factors can obscure fundamental trends in the budget. For example, high unemployment automatically worsens the deficit—principally because of lower revenues accompanied by higher outlays for unemployment compensation and other programs. The standardized-employment deficit removes such factors from the budget to determine the extent to which the deficit reflects a structural imbalance (a deficit that would exist in an economy operating at its potential). The current projections show only a small difference between the deficit estimated under current-policy economic projections with discretionary inflation and the standardized-employment deficit (see Table 2-1). That outcome is not surprising since CBO's economic forecast assumes that the economy will continue to operate near its potential throughout the projection period.

The on-budget deficit is rooted in legislation that granted special, off-budget status to particular government programs. The two Social Security trust funds—Old-Age and Survivors Insurance and Disability Insurance—were granted off-budget status in the Balanced Budget and Emergency Deficit Control Act of 1985. Legislation enacted in 1989 excluded the much smaller net outlays of the Postal Service from on-budget totals. Because the income of the Social Security trust funds currently exceeds expenditures, removing Social Security (and the Postal Service) from the on-budget totals makes the remaining deficit substantially larger (see Table 2-1).

Changes in the Budget Outlook Since December

The budget outlook under balanced-budget economic assumptions has improved slightly since CBO published its projections last December. Projected deficits are down in every year—by $28 billion in 1996, $16 billion in 1997, and $18 billion in 2002 (see Table 2-2). Much of that downward revision stems from changes in the projected level of discretionary spending, which in 1996 is $19 billion below the amount anticipated in December. Reductions in 1996 appropriation bills have a continuing effect in 1997; for 1998, the Administration's lower projections of inflation required the Office of Management and Budget (OMB) to reduce the cap on discretionary outlays by $10 billion. CBO has projected that re-

Box 2-1.
CBO Estimate of the Fiscal Dividend

The fiscal dividend is the portion of the total amount of deficit reduction needed to balance the budget that can be attributed to the macroeconomic improvements expected as a result of balancing the budget. That deficit reduction is automatic, giving policies that reduce the deficit an extra boost from its effects on the economy. The Congressional Budget Office estimates that balancing the budget in 2002 (and maintaining a balanced budget thereafter) will reduce interest rates 110 basis points (1.1 percentage points) by 2000 and increase the rate of growth of real GDP by about 0.1 percent a year. Those macroeconomic effects are discussed in more detail in Chapter 1.

The budgetary effects of those factors will both reduce outlays and increase revenues. Spending will decline because of the sensitivity of the government's net interest expense to interest rates (CBO also calculates a slight effect on spending for student loans). Revenues will increase because national output is higher and because more income is received from corporate profits and less from interest income, much of which accrues to tax-exempt entities.

CBO's current estimates of the fiscal dividend are given in the table below. Approximately 60 percent of the cumulative fiscal dividend of $254 billion results from reduced outlays on government expenditures that are sensitive to interest rates, principally net interest. Another 30 percent comes from increased revenues. The final tenth of the dividend reflects lower interest expenses but is caused indirectly by the reduction in government debt that will result from the savings just described rather than directly by lower interest rates.

Changes in the Deficit Resulting from the Economic Effects of Balancing the Budget (By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000	2001	2002	Total, 1996-2002
Change Resulting from Lower Interest Rates								
Outlays								
Net interest	a	-3	-11	-22	-32	-38	-43	-150
Student loans	a	a	a	a	-1	-1	-1	-2
Revenues								
Federal Reserve earnings[b]	a	a	1	2	4	5	5	17
Shift in income shares	a	-2	-7	-12	-16	-18	-19	-74
Total	a	-5	-17	-32	-45	-52	-58	-209
Change in Revenues Resulting from Higher Gross Domestic Product	a	a	-1	-3	-4	-5	-7	-21
Debt Service	a	a	-1	-2	-4	-7	-10	-24
Total Effect on the Deficit	a	-5	-19	-37	-53	-64	-75	-254

SOURCE: Congressional Budget Office.

a. Less than $500 million.

b. Revenue reductions are shown as positive because they increase the deficit.

Table 2-2.
Changes in CBO Deficit Projections Since December (By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
December Baseline Deficit	172	182	183	195	204	211	228	244	266	294
Legislative Changes										
Revenues	a	a	a	a	a	a	a	a	a	a
Discretionary outlays	-19	-8	0	0	0	0	0	0	0	0
Mandatory outlays	3	2	-1	-2	-2	-2	-2	-1	-1	-1
Deficit	-15	-6	-1	-2	-2	-2	-2	-1	-1	-1
Economic Changes										
Revenues	-2	1	1	2	5	6	8	11	13	15
Outlays										
Net interest	-2	-6	-6	-7	-8	-10	-14	-18	-22	-29
Other mandatory outlays	-1	-2	-2	-2	-2	-2	-2	-2	-2	-2
Subtotal	-4	-8	-8	-10	-11	-12	-17	-20	-25	-31
Deficit	-6	-7	-8	-7	-6	-6	-9	-9	-12	-17
Technical Changes										
Revenues										
Expiring excise taxes	5	7	8	8	8	9	9	10	10	11
Other revenues	-4	-2	-1	-1	a	a	1	1	2	3
Subtotal	1	5	7	7	8	9	10	11	12	14
Discretionary outlays	0	0	-10	-9	-10	-10	-10	-10	-11	-11
Mandatory outlays										
Medicare and Medicaid	-2	-3	-2	-4	-5	-7	-9	-11	-14	-19
Social Security	-1	-1	-1	-1	-2	-2	-3	-3	-4	-5
Supplemental Security Income	a	-1	-1	-1	-2	-2	-3	-3	-4	-5
Broadcast spectrum auctions	-3	-10	-2	a	a	0	0	0	0	0
Net interest	-1	a	a	1	1	1	3	4	6	9
Other mandatory outlays	a	6	10	4	6	5	5	5	7	7
Subtotal	-8	-8	4	-1	-2	-6	-7	-8	-8	-12
Deficit	-7	-3	1	-3	-4	-7	-7	-7	-7	-9
Debt Service	a	-1	-1	-1	-1	-1	-1	-1	-2	-2
Total Changes	-28	-16	-8	-13	-12	-16	-18	-19	-22	-29
March Baseline Deficit with Balanced Budget Economic Assumptions	144	165	175	182	191	194	210	225	244	265
Changes from Adopting Current-Policy Economic Assumptions	a	5	19	37	53	64	75	86	98	111
March Baseline Deficit with Current-Policy Economic Assumptions	144	171	194	219	244	259	285	311	342	376

SOURCE: Congressional Budget Office.

NOTE: Reductions in revenues are shown with a positive sign because they increase the deficit.

a. Less than $500 million.

duction through 2006. Other revisions include slower growth in outlays for Medicare, Medicaid, and Social Security, which is partially offset by the expiration of certain taxes and other technical adjustments. The budget outlook for 1996 has also improved significantly compared with CBO's projections of January 1995 (see Box 2-2).

A Quick Review of 1995

Last August, CBO projected a 1995 deficit of $161 billion. Two months later, the Treasury Department reported that the actual deficit totaled $164 billion. CBO overestimated revenues by about $2 billion and underestimated outlays by $1 billion. Individual income taxes came in slightly lower than projected, and other taxes came in higher; mandatory spending was slightly greater than anticipated. Using earlier projections, the Congressional budget resolution for 1995, adopted in May 1994, anticipated a deficit of $175 billion. Higher outlays of $6 billion and higher revenues of $17 billion account for the difference of $11 billion between the budget resolution total and the actual deficit (see Appendix B).

Revisions to the 1996-2006 Projections

CBO traces its revisions to the budget outlook since December to three sources: newly enacted legislation, changes in the economic outlook, and other, so-called technical factors. Both now and in December, the budget outlook assumes that discretionary spending grows with inflation up to the level of the caps.

Recent Legislation. Relative to the levels of the caps assumed in CBO's December baseline, appropriations enacted in 1996 are expected to reduce outlays by $19 billion in 1996 and $8 billion in 1997. (Those figures do not reflect the Omnibus Consolidated Rescissions and Appropriations Act of 1996, which be-

Box 2-2.
Changes in CBO Deficit Projections

In January 1995, the Congressional Budget Office projected that the deficit for fiscal year 1996 would total $207 billion. In the past 15 months, that estimate has fallen by $63 billion—to $144 billion (see the table below). The projected deficits for 1997 through 2000 have also declined but by smaller amounts.

Much of the drop in the projected deficits stems from changes in economic conditions, primarily lower interest rates. For 1996, interest rates are now projected to be between 0.9 and 1.2 percentage points lower than CBO projected in January 1995. Interest rates for future years also are projected to be lower, but by a smaller amount. Almost all of the drop in projected deficits for the years after 1997 is attributable to that reduction in interest rates.

For 1996, two other factors also contribute. First, appropriations for 1996 are well below the maximum levels allowed by the Budget Enforcement Act. Second, CBO has reduced its estimates of outlays for Medicare and Medicaid, the refundable portion of the earned income credit, mortgage insurance provided by the Federal Housing Administration, and a few other programs. The effects of those reductions are also felt in 1997.

Changes in CBO Deficit Projections
Since January 1995
(By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000
January 1995 Baseline Deficit	207	224	222	253	284
Changes					
Economic	-27	-34	-29	-29	-32
Legislative	-17	-6	-1	-2	-2
Technical	-19	-13	1	-3	-6
Total	-63	-53	-29	-34	-39
April 1996 Baseline Deficit	144	171	194	219	244

SOURCE: Congressional Budget Office.

came law on April 26.) Discretionary outlays are therefore expected to be $13 billion below the 1995 nominal level in 1996 and equal to it in 1997. If 1996 spending equals expectations, it will mark only the second time in 30 years that discretionary outlays have declined from the level of the previous year.

Enacted legislation affecting direct (mandatory) spending or revenues has a relatively small effect on the projections. The Federal Agricultural Improvement and Reform Act of 1996 will increase outlays modestly in the near term but reduce them in later years as transition payments for commodity price support programs are eliminated. The Contract with America Advancement Act of 1996 will reduce outlays by eliminating Social Security and Supplemental Security Income benefits for certain substance abusers and dependent stepchildren, but that amount will be largely offset by increased spending on Social Security beneficiaries who continue to work in retirement. Such legislation increases the deficit by $3 billion in 1996 but lowers it by at least $1 billion a year after 1997 (see Table 2-2). In addition, the Telecommunications Act of 1996 will require a significant increase in both mandatory spending and revenues but will have a net effect of zero on the deficit because the bill expands payments for universal telephone service but also provides additional receipts to support those expenditures.

Economic Changes. Apart from the current year, revisions that stem from changes in the economic outlook explain roughly half of the improvement in the deficit projections since December. A modest downward revision in revenues is more than offset by lowered outlays. Projected revenues from the corporate income tax have been scaled back in every year as a result of lower expectations for taxable profits. Projected revenues from the individual income tax and social insurance taxes have been raised in the earlier years of the forecast but reduced for years after 2001. Those revisions, however, are more than offset by the reduction in the government's interest expense that stems from a drop of 30 basis points (0.3 percentage points) in CBO's forecast of short-term interest rates and 90 basis points in its forecast of rates on 10-year Treasury notes. The net effect of economic changes is under $10 billion annually for most of the projection period (see Table 2-2).

Technical Reestimates. Technical revisions are any changes that are not ascribed to legislation or to changes in the macroeconomic forecast. Such revisions account for the balance of the post-1998 improvement in CBO's deficit outlook.

A revision to the discretionary spending caps required by the Balanced Budget Act, which CBO characterizes as technical, accounts for a sizable portion of the change in deficits for 1998 through 2006. In its *Budget Enforcement Act Preview Report*, which was published with the President's budget submission, OMB made a downward adjustment to the caps to reflect a corresponding downward adjustment in the Administration's forecast of the GDP price index compared with its forecast of February 1995, when the caps were last adjusted. Although the adjustment covers only the period ending in 1998, its effect on 1998 spending ripples throughout the projection period in CBO's estimates of the capped baseline with adjustments for inflation.

Lower projected spending for Social Security, Medicare, and Medicaid benefits also reduces projected deficits. In the Social Security program, the revision reflects a reduction in the assumed average benefits of new beneficiaries. In the Medicare program, CBO has lowered its estimate of increases in the volume and intensity of services provided to recipients, because actual growth from those sources has been less than expected for the past few years. In Medicaid, the revision reflects the zero growth in outlays in the first four months of 1996, which was incorporated into the projections as a change in the level of benefits throughout the projection period.

These favorable revisions are substantially offset by others that increase the estimated deficit (see Table 2-2). Expiration of the excise taxes for the Airport and Airway and Leaking Underground Storage Tank Trust Funds and the Hazardous Substance Superfund will reduce revenues by $5 billion in 1996 and $11 billion by 2005. As required by the Balanced Budget Act, CBO assumes that excise taxes dedicated to trust funds and scheduled to expire during the budget projection period are extended. Those excise taxes have now expired, however, and have therefore been excluded from the baseline.

The Revenue Outlook

Federal revenues are expected to be $1,428 billion, or 19.1 percent of GDP, in 1996. They are projected to grow less rapidly than the economy in the next five years, slipping to 18.5 percent of GDP by 2001, and then to keep pace with GDP (see Table 2-3).

In relation to GDP, revenues will be higher than the levels typical of the past three decades. In 1960 through 1995, revenues averaged 18.1 percent of GDP. (Those percentages are lower than in previous reports and in the 1997 budget because GDP was redefined earlier this year.) In only five years did revenues reach or top 19 percent, and those years were unusual for one reason or another. In 1969 and 1970, taxes were hiked to help finance the Vietnam War, and in 1980 through 1982—before the Reagan Administration's tax cut and the subsequent indexing of tax brackets to the price level—high inflation pushed up revenues.

Underneath the overall relative stability of the revenue-to-GDP ratio are some striking shifts in

Table 2-3.
CBO Projections for Revenues Under Current-Policy Economic Assumptions (By fiscal year)

	Actual 1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
					In Billions of Dollars							
Individual Income Taxes	590	636	661	694	730	769	811	853	898	946	997	1,051
Corporate Income Taxes	157	169	171	172	171	171	174	179	185	194	204	214
Social Insurance Taxes	484	504	531	553	580	609	636	666	696	727	762	800
Excise Taxes	57	52	51	52	53	53	54	55	56	56	57	58
Estate and Gift Taxes	15	16	17	18	19	20	21	22	23	24	25	27
Customs Duties	19	20	20	21	21	22	23	25	27	29	31	33
Miscellaneous	32	30	32	34	35	37	39	41	46	47	48	50
Total	1,355	1,428	1,483	1,544	1,609	1,681	1,758	1,840	1,931	2,023	2,124	2,232
On-budget	1,004	1,063	1,098	1,142	1,186	1,236	1,294	1,354	1,423	1,493	1,568	1,649
Off-budget[a]	351	365	385	402	423	444	464	486	508	530	556	584
					As a Percentage of GDP							
Individual Income Taxes	8.2	8.5	8.4	8.4	8.5	8.5	8.5	8.6	8.6	8.6	8.7	8.7
Corporate Income Taxes	2.2	2.3	2.2	2.1	2.0	1.9	1.8	1.8	1.8	1.8	1.8	1.8
Social Insurance Taxes	6.7	6.7	6.8	6.7	6.7	6.7	6.7	6.7	6.7	6.6	6.6	6.6
Excise Taxes	0.8	0.7	0.6	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.5	0.5
Estate and Gift Taxes	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Customs Duties	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Miscellaneous	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Total	18.9	19.1	18.9	18.8	18.7	18.6	18.5	18.5	18.5	18.5	18.5	18.5
On-budget	14.0	14.2	14.0	13.9	13.8	13.7	13.6	13.6	13.6	13.6	13.7	13.7
Off-budget[a]	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.8	4.8	4.8

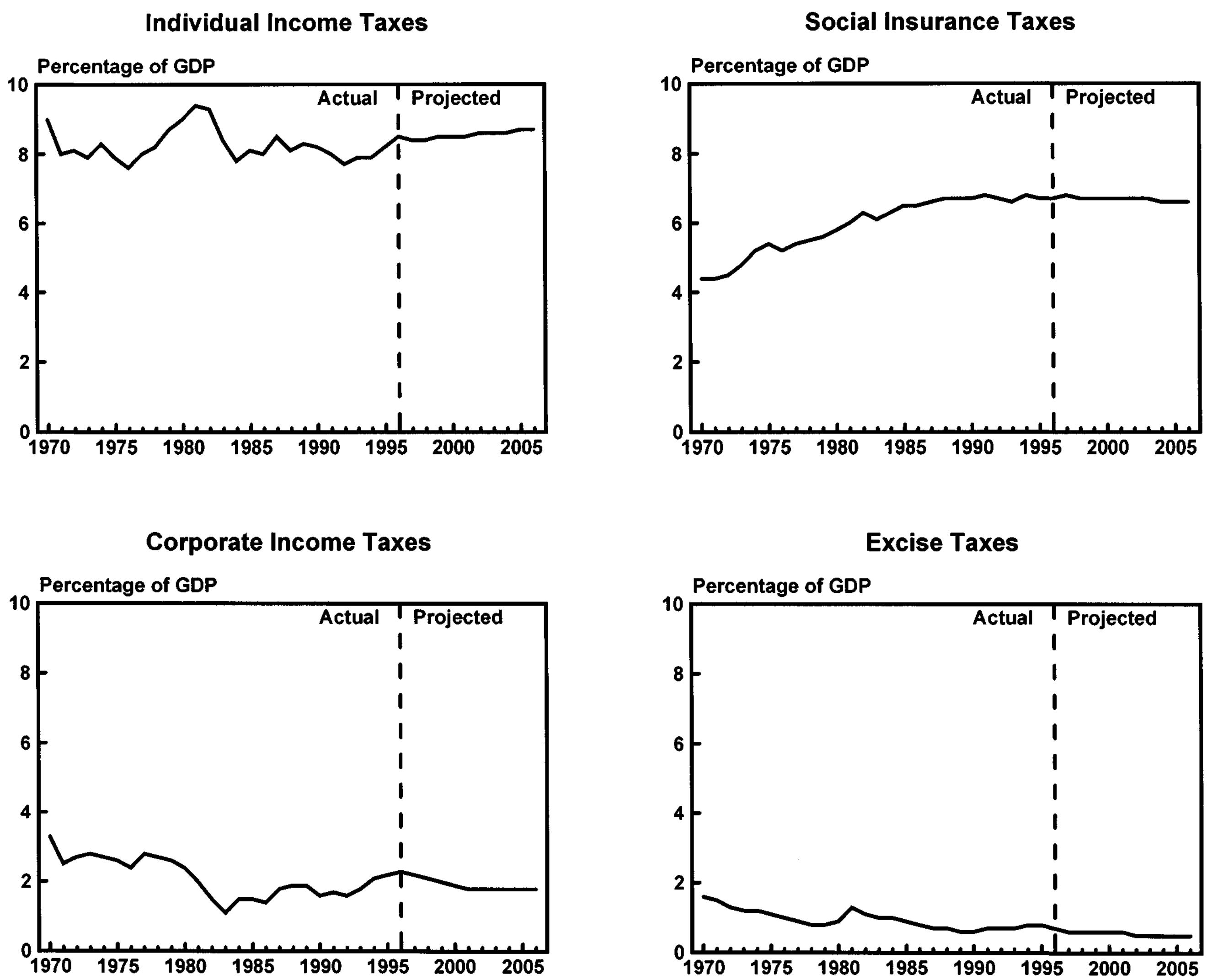
SOURCE: Congressional Budget Office.

a. Social Security.

composition (see Figure 2-1). The most visible is the government's increasing reliance on revenues from social insurance taxes, chiefly those for Social Security and Medicare's Hospital Insurance (now about 7 percent of GDP), and its diminishing reliance on corporate income taxes and excise taxes (now about 2 percent and 1 percent of GDP, respectively). Individual income taxes, the biggest contributor to government coffers, have fluctuated in the range of 8 percent to 9 percent of GDP for three decades. Social insurance taxes are expected to hold steady as a share of GDP during the projection period. Individual income taxes are expected to increase, and corporate and excise taxes are expected to decrease.

This shift in the composition of revenues is also apparent when each source of revenue is viewed as a share of total revenues. Social insurance taxes contribute 35 percent of total revenues, up from 25 percent a quarter-century ago. The share of corporate income and excise taxes, in contrast, has declined from 25 percent in 1970 to 15 percent today. For

Figure 2-1.
Revenues by Source as a Share of GDP Under Current-Policy Economic Assumptions



SOURCE: Congressional Budget Office.

more than three decades, the share contributed by the individual income tax has remained steady at close to 45 percent. Other taxes have maintained a fairly constant share of about 5 percent for two decades. More detailed historical data are contained in Appendix E, which lists annual revenues for each of those sources and spending by outlay category.

Baseline Projections

In the baseline, individual income taxes are the only source of revenue that will grow even modestly as a share of GDP, from 8.5 percent in 1996 to 8.7 percent in 2006. The GDP share creeps up over time as rising real incomes cause a larger fraction of income to be taxed in higher tax brackets.

Social insurance taxes essentially maintain their share of GDP—just under 7 percent. The slight decline in the later years of the projection period results principally from the taxes that finance unemployment benefits. Those taxes do not keep pace with increased GDP for three reasons. First, states are able to reduce their tax rates as the unemployment trust fund is replenished. Second, the Federal Unemployment Tax Act (FUTA) applies only to the first $7,000 of each covered worker's salary, a figure that remains unchanged despite economic growth. Third, a FUTA surtax of 0.2 percentage points expires at the end of 1998.

The corporate income tax is projected to fall from 2.3 percent of GDP in 1996 to 1.8 percent by 2001, mirroring a decline in corporate profits as a share of GDP. Similarly, excise taxes (which grew in the early 1990s when some tax rates were increased) will fall marginally as a share of GDP, both because some taxes have expired and because excise taxes fail to grow with the economy since most are levied per unit of good or per transaction rather than as a percentage of value.

Expiring Provisions

CBO's baseline projections for revenues assume that current tax law remains unchanged and that scheduled changes and expirations occur on time. One category of taxes—excise taxes dedicated to trust funds—constitutes the sole exception to that approach. Under the baseline rules, those taxes are included in the projections even if they are scheduled to expire. The only trust fund excise taxes slated to expire over the projection period are those for the Highway Trust Fund. By 2006, extending those taxes at today's rates would contribute $30 billion to baseline revenues, or more than half of the total excise taxes.

Nine provisions that reduce taxes have expired recently—four at the end of 1994 and five during 1995 (see Table 2-4). The baseline assumes that those provisions will not be extended. If the Congress extended all nine preferences (items that reduce revenues) at least through the projection period, baseline revenues would be smaller by about $5 billion in 2002 and $7 billion in 2006. Extending the four taxes that expired at the end of 1995 would boost net baseline revenues by almost $8 billion in 2002 and $9 billion in 2006.

Another 10 tax provisions are slated to expire between 1996 and 2004. Extending the four that lose revenue—including the nonconventional fuels credit that expires at the end of this year—would have a small effect on the baseline in 2006. Extending the six that increase revenue would raise about $2 billion in 2006.

The Spending Outlook

CBO expects that federal spending will total almost $1.6 trillion in 1996. That spending has been divided into several convenient clusters for more than a decade. Those categories were formalized in the Budget Enforcement Act of 1990.

Discretionary spending denotes programs controlled by annual appropriation bills. For those programs policymakers can decide afresh each year how many dollars will be devoted to continuing existing activities and funding new ones. The baseline projections depict the path of discretionary spending as a whole, using as a starting point the appropriations for 1996 (assuming an annualized rate of spending for programs covered by a continuing resolution).

CBO makes two projections with different assumptions regarding the future path of appropriated spending. In the first projection, discretionary spending is assumed to grow from the 1996 level at the rate of inflation, subject to the limits or caps that are in effect through 1998. Because the cap on general-purpose discretionary spending is constraining in 1998, CBO assumes that general-purpose spending grows

Table 2-4.
Effect of Extending Tax Provisions That Have Recently Expired or Will Expire in 1996 Through 2006 (By fiscal year, in billions of dollars)

Tax Provision	Expiration Date	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
					Expired Provisions[a]						
Deduction for Contributions to Private Foundations	12/31/94	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Targeted Jobs Tax Credit	12/31/94	-0.1	-0.2	-0.3	-0.4	-0.4	-0.4	-0.5	-0.5	-0.5	-0.5
Exclusion for Employer-Provided Education Assistance	12/31/94	-1.1	-0.6	-0.7	-0.7	-0.7	-0.8	-0.8	-0.9	-0.9	-0.9
Orphan Drug Tax Credit	12/31/94	-0.1	b	b	b	b	b	b	b	b	b
Special Rule for Certain Group Health Plans	5/12/95	b	b	b	b	b	b	b	b	b	b
Credit for Research and Experimentation	6/30/95	-2.4	-1.6	-1.9	-2.2	-2.4	-2.6	-2.9	-3.1	-3.4	-3.7
Rules for Allocation of Expenses for Research and Experimentation	7/31/95	-1.2	-0.5	-0.6	-0.6	-0.6	-0.6	-0.7	-0.7	-0.7	-0.8
Extension of Generalized System of Preferences[c]	7/31/95	-0.9	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Commercial Aviation Exemption for the 4.3 Cent per Gallon Tax on Transportation Fuels[c]	9/30/95	-0.9	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.6	-0.6	-0.6
Airport and Airway Trust Fund Taxes[c]	12/31/95	4.0	4.9	5.1	5.4	5.8	6.1	6.4	6.8	7.2	7.6
LUST Trust Fund Taxes[c]	12/31/95	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Hazardous Substance Superfund Excise Taxes[c]	12/31/95	0.7	0.7	0.7	0.7	0.7	0.7	0.8	0.8	0.8	0.8
Corporate Tax Dedicated to Superfund	12/31/95	0.9	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
					Provisions Expiring in 1996						
Nonconventional Fuels Credit for Fuel from Biomass and Coal	12/31/96	b	b	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2

with inflation from that 1998 cap level in subsequent years. In the second projection, all discretionary funding remains frozen at the dollar level provided in the 1996 appropriation bills in all years through 2006. In that projection, the caps are never constraining.

Discretionary spending is expected to decrease slightly as a percentage of GDP under both projections. In the first projection, that share will drop from its current 7 percent to slightly under 6 percent in 2006 (see Table 2-5). In the second, such spending will drop to just over 4 percent of GDP.

Table 2-4.
Continued

Tax Provision	Expiration Date	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
			Provisions Expiring in 1998								
FUTA Surtax of 0.2 Percentage Points[c]	12/31/98	n.a.	n.a.	0.1	1.2	1.2	1.2	1.3	1.3	1.3	1.3
			Provisions Expiring in 1999								
Railroad Uses of Diesel Fuel, 1.25 Cents per Gallon[c]	9/30/99	n.a.	n.a.	n.a.	d	d	d	d	d	d	d
Luxury Tax on Passenger Vehicles[c]	12/31/99	n.a.	n.a.	d	0.3	0.4	0.5	0.5	0.5	0.5	0.5
Noncommercial Motorboat Diesel Fuel, 20.1 Cents per Gallon[c]	12/31/99	n.a.	n.a.	n.a.	b	d	d	d	d	d	d
Credits for Electricity Production from Wind and Biomass	5/31/99-wind 6/30/99-biomass	n.a.	n.a.	n.a.	b	b	b	b	b	-0.1	-0.1
			Provisions Expiring in 2001								
Andean Trade Preference Initiative[c]	12/04/01	n.a.	n.a.	n.a.	n.a.	b	b	b	b	b	b
			Provisions Expiring in 2003								
IRS User Fees[c]	09/30/03	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	d	d	d
			Provisions Expiring in 2004								
Abandoned Mine Reclamation Fund	09/30/04	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	d	d
Deductions and Credits for Clean-Fuel Vehicles and Refueling Properties	12/31/04	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	b	b

SOURCE: Joint Committee on Taxation.

NOTES: LUST = Leaking Underground Storage Tank; FUTA = Federal Unemployment Tax Act; IRS = Internal Revenue Service; n.a. = not applicable.

a. Assumes an enactment date for the expired provisions of October 1, 1996.

b. Loss of less than $50 million.

c. Net of income and payroll tax offsets.

d. Increase of less than $50 million.